TruWest Credit Union
P.O. Box 3489 | Scottsdale, Arizona 85271-3489
Arizona 480.441.5900
Texas 512.996.4000
Toll-free 800.528.1441
truwest.org

May 21, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA, 22314-3428

RE: Comments on Proposed Rule: Prompt Corrective Action - Risk-Based Capital

Dear Mr. Poliquin and Members of the Board:

I am writing on behalf of TruWest Credit Union, which serves communities in and around both Phoenix, Arizona, and Austin, Texas. We have over 64,000 Members and $850 Million in assets. TruWest Credit Union appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

Conceptually, we believe that capital requirements for credit unions should be risk-based, taking into account the unique risk inherent in each credit union's individual balance sheet; however, we believe there are significant flaws in the Risk-Based Capital proposal, as written. We believe that these flaws could be remedied by conformance to the Basel III risk weights that will soon apply to small banks. As written, the proposed capital requirements could reduce the amount of lending TruWest Credit Union is able to provide its members and reduce the earnings of our member owned cooperative - thus reducing the financial benefits we are able to pass through to our membership. They could even serve, perversely, to incent us to increase risk on our balance sheet.

Basel III risk-based capital standards represent a consensus developed over a period of many years, after exhaustive due diligence, research, and debate. Since these standards will apply to a broad swath of players in the financial marketplace, deviations from this standard requiring higher capital will create a handicap for credit unions.

For example, first mortgages, to the extent they exceed 35% of total assets would have a 100% risk weighting under the NCUA proposal, thus requiring 10.5% capital to maintain a well-capitalized designation. This is twice the 5.25% capital required of small banks under Basel III. What is the justification for doubling the required capital a credit union must maintain versus a bank? This high capital requirement for first mortgage holdings is not supportive of housing finance, and is thus counter to other nationwide efforts to support housing prices and increase homeownership. TruWest Credit Union believes that credit union support of member housing finance is an important part of the credit union cooperative mission, and does not see the public purpose in capital requirements which serve to restrict housing finance, and thus homeownership.

Credit unions are at an even greater disadvantage for second mortgages. To the extent these loans exceed 25% of total assets, 15.75% capital is required to maintain a well-capitalized designation under the proposal. This is three times the 5.25% capital required of small banks under Basel III. Again, this divergence from Basel III is not justified in the proposed regulation. And just as with second mortgages, a similar inequity exists for member business loans (MBL).

Another fundamental flaw in the proposal, as it is currently written, is its attempt to limit investment interest rate risk. Capital requirements for investments perceived to create interest rate risk are given high capital requirements, while those investments perceived as benign are granted lower capital requirements. For example, a Federal agency bond with a 10-year life is assigned a capital requirement of 21% - ten times the 2.1% required of small banks under Basel III. On the other hand, a Federal agency bond with a life of less than one year is assigned a capital requirement of just 2.1% - identical to that required of small banks under Basel III.

The inference is that a long-term investment creates risk that a short-term investment does not create – something that may or may not be true. For example, in early 2007, TruWest Credit Union was paying a competitive 0.75% on its share draft/checking accounts and could have invested those funds in agency notes with a life of less than one year paying 5.25%, for a net spread of 4.50%. With non-interest expenses approximating 4% of total assets, this would have left us a return on assets of 0.50%.

Three years later, by early 2010, yields offered on short-term agency notes had fallen to 0.15% - the same rate then paid by TruWest Credit Union on its checking accounts. In other words, due to interest rate risk, the net spread for short-term agency notes funded by checking accounts fell from 4.50% (the 5.25% yield on short-term agency bonds less 0.75% paid on checking accounts) to 0% (0.15% yield on short-term agency bonds less 0.15% paid on checking accounts), and the return on assets after noninterest expenses of 4% fell from a positive 0.50% to a negative 4.00%.

Thus, what appears in isolation as a low interest rate risk asset (short-term agency note) can actually be high risk, when the balance sheet is viewed as a whole. As this example demonstrates, there are no "good" or "bad" assets, as the interest rate risk of a financial institution is a function of both its assets and its liabilities or funding sources. Regulations which seek to label some assets as "good" and others as "bad" can perversely serve to encourage credit unions to increase risk on the balance sheet, as the above example demonstrates. We believe attempting to use risk-based capital regulations to manage interest rate risk is inherently flawed. In fact, this focus on interest rate risk could create future unintended consequences.

For a credit union like TruWest, with a complex balance sheet including multiple fixed-rate and variable-rate mortgage loan programs, along with core deposits that re-price infrequently, interest rate risk can only be accurately calculated using complex Net Economic Value and Income Simulation models. The complexity of these models does not allow their inputs to be reduced to simple risk-based net worth metrics – something likely considered as the Basel III capital standards were crafted. Fortunately, the NCUA has issued a comprehensive set of rules and regulations pertaining to interest rate risk, which focus on Net Economic Value and Income Simulation modeling. An example of this can be found in 12 CFR Part 741, "Interest Rate Risk Policy and Program," issued February 2, 2012.

The contortions required to force interest rate risk controls into the risk-based capital standards create a host of obvious inequities. For example, if a credit union has member first mortgage loans totaling less than 25% of total assets, some of which are 30-year fixed-rate mortgages, it would be required under the NCUA proposal to have just 5.25% capital for those 30-year fixed-rate mortgages in order to be well capitalized. As credit unions in Phoenix, Arizona, such as TruWest Credit Union saw during the Great Recession, there is very real risk of credit loss on those mortgages. A prudent desire to eliminate that risk of default could lead us to securitize those 30-year fixed-rate mortgages with a GSE such as Fannie Mae. The member loan payments would continue to come to TruWest Credit Union, with servicing performed by us as before, but Fannie Mae would be providing credit insurance against default for a fee. Under the NCUA proposal, however, the risk-based capital requirement would rise from 5.25% to 15.75%. Reducing risk by buying credit protection from Fannie Mae would thus require us to provide three times the capital.

TruWest Credit Union operates in a very competitive environment. We are pleased to face that competition on a level playing field, such as the capital standards applicable to small banks under Basel III. But regulations that require us to hold more capital than our bank competitors restricts our capacity to grow and serve our communities. Regulations that restrict our ability to expand whenever member demand presents itself in mortgage or business loans force us to allow that business to go to a competitor, likely a bank with less restrictive regulations. Regulations that encourage us to take on interest rate risk or to retain credit risk, as described above, serve no practical purpose, and in the long run will serve to both increase risk and reduce credit union earnings. Because TruWest Credit Union is a member owned cooperative, reduced earnings will reduce the financial benefits we are able to pass through to our membership.

All of these problems could be resolved by conformance to the capital weights set to be implemented in the coming years under Basel III.

In conclusion, TruWest Credit Union feels very strongly that the proposal, as it is currently written, puts our organization at a significant competitive disadvantage with the banks. It does not comply with the statutory requirements of the Federal Credit Union Act for comparability with FDIC rules implementing Basel III. Further, this proposal will ultimately harm not only our members but also consumers in general.

TruWest Credit Union requests that the Administration listen to the concerns raised by the credit union community, including those raised by the United States Congress, and abandon the proposed rule in its entirety. At the very least, we urge the Administration to propose and adopt a rule that does not depart from the FDIC-Basel III regulatory concept, except as appropriate to reflect our industry's uniqueness.

Thank you for the opportunity to comment on this proposed rule and for considering our views on Risk-Based Capital requirements.

Respectfully submitted,

Daniel F. Desmond
President & CEO
TruWest Credit Union

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